Credit Opinion: **Nederlandse Waterschapsbank N.V.**

Nederlandse Waterschapsbank N.V.

The Hague, Netherlands

Ratings

Category	Moody's Rating
Outlook	Stable
Bank Deposits	Aaa/P-1
Bank Financial Strength	A-
Senior Unsecured	Aaa
Other Short Term	P-1

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Key Indicators

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	Jun 30 2008	2007	2006	2005	2004	2003	[1]Avg. 2003-2007
Total assets (EUR billion)	38.4	38.8	35.2	33.2	28.0	25.7	8.55
Total capital (EUR billion)	1.1	1.1	1.3	1.3	1.1	1.1	0.64
Return on average assets	0.12	0.19	0.29	0.64	0.38	0.32	0.36
Recurring earnings power [2]	0.16	0.25	0.42	0.44	0.38	0.32	0.36
Net interest margin (%)	0.33	0.32	0.38	0.43	0.43	0.38	0.39
Cost/income ratio (%)	21.7	12.1	9.5	6.2	8.0	11.2	9.4
Tier 1 ratio (%)	--	96.0	114.6	110.0	101.5	86.9	101.8

[1] Compound annual growth rate for total assets and total capital [2] Preprovision income % average assets

Opinion

SUMMARY RATING RATIONALE

In accordance with Moody's rating methodology for government-related issuers (GRIs), the Aaa/Prime-1 debt and deposit ratings and A- bank financial strength rating of Nederlandse Waterschapsbank N.V. (NWB) reflect the combination of the following inputs:

i) A baseline credit assessment of 2 (on a scale of 1 to 21, where 1 represents the lowest credit risk);

ii) The Aaa local currency deposit ceiling of the Netherlands;

iii) High dependence;

iv) High support.

NWB has a solid market share in lending to Dutch social housing corporations, healthcare institutions, municipal authorities and water boards. It may only lend to public or publicly guaranteed and entities and has never suffered a loan loss. The bank's lending is carried out at very narrow margins, reflecting the low risk profile of the loans. Its profitability level reflects the fact that profit maximisation is not an objective for the bank. NWB has a lower level of available liquid assets on its balance sheet than other specialised lenders, but a mitigating factor is that a large portion of the loan portfolio is easily repo-able with the Dutch central bank. Capitalisation is among the highest for specialised lenders in Europe.

In view of the Netherlands' geography, the Dutch water boards play an extremely important role in the country. In addition, given that local governments are responsible for a large proportion of total government spending, NWB, as one of the principal financiers in this sector, holds an important position within Dutch government finance.

Moody's therefore believes that, in the highly improbable event of NWB facing financial difficulty, there is a high probability that the Dutch government would extend support. We also believe that the Dutch government would not take any steps that would compromise the bank's ability to continue performing its role.

Dependence between NWB and the central government is deemed to be high as the majority of its loan portfolio has exposures to local governments, water boards and other public bodies (guaranteed by the central government). Under the bank's article of association, NWB shares can be held only by legal entities governed by public law. NWB is 81% owned by the Dutch water boards, 17% by the Dutch government and 2% by Dutch provinces.

Credit Strengths

Credit strengths of Nederlandse Waterschapsbank N.V. (NWB) are:

- Strong and well established franchise as a specialised lender to the Dutch public sector, including the water control boards

- Long track record of high asset quality

- Ownership structure underpins NWB's importance as a specialised lender

- Excellent operating efficiency thanks to low cost base

- High level of capitalisation ratios, albeit decreasing

Credit Challenges

Credit challenges of the bank are:

- Low profitability due to narrow margins for Dutch public sector lending

- Reduction in available liquid assets on balance sheet, although this is mitigated by active liquidity management and the possibility of repo-ing a large part of the assets

- Reliance on wholesale funding

Rating Outlook

The outlook on all of the bank's ratings is stable, reflecting NWB's secure business franchise, its low risk profile, adequate financials and the fact that the bank is unlikely to be privatised.

What Could Change the Rating - Up

NWB's debt ratings are already at the highest level.

What Could Change the Rating - Down

Given the implied government support for the bank factored into its long-term rating, it is difficult to see potential downward pressure, unless there is an adverse change in the sovereign rating or in the ownership and support structure, a remote possibility.

Recent Results and Developments

In January 2009, NWB published its preliminary result for the year 2008. The bank granted a record of more than EUR 7 billion in lending, which was slightly higher than in 2007. According the preliminary result, net profit for 2008 decreased significantly to EUR 5 million EUR from 70.7 million 2007, a decrease of 93%. This was mainly due to unrealised revaluation of certain of NWB's high grade bond assets, for example EUR 65 million on loans and state guaranteed securities and EUR 22 million on Dutch government bonds. The result for the year excluding these and other unrealised revaluations increased 12%, to EUR 114 million in 2008 compared to EUR 101 million on 2007.

The preliminary result indicate that Tier 1 ratio decreased in 2008, but was still at the very high level of 55%, compared to 68% in 2007 (Basel 2 definition).

DETAILED RATING CONSIDERATIONS

Detailed considerations for NWB's currently assigned ratings are as follows:

Qualitative Rating Factors

Franchise Value

Trend: Neutral

NWB was established in 1954 as a specialised lending institution to provide the Dutch local governments and water boards with long-term and short-term funding at cost-efficient levels. All of the bank's funding was government-guaranteed until July 1989. The explicit support was subsequently withdrawn as part of a wider government policy of reducing public participation and guarantees.

Over the years, NWB has extended its lending activities to encompass other public sector entities such as water supply companies, municipalities, housing corporations and the healthcare sector. According to its articles of association, it can only extend loans to local governments, the central government or similar entities, or entities guaranteed by local governments, the central government or entities with similar risk profiles. Many of the financial institutions that previously provided loans to the public sector have over time withdrawn from this market due to the low margins which do not satisfy shareholder values. Although competition for the funding of larger public entities remains fierce and players in this particular segment includes a couple of foreign players, NWB's main competitor for the majority of its lending activities is Bank Nederlandse Gemeenten (BNG, rated Aaa/Prime-1/A).

At the end of 2007, NWB maintained dominant market shares in the segments in which it is active, as follows:

91% of total funding to the water boards

59% of funding to provinces

22% of funding to municipalities

25% of lending to social housing corporations

19% of lending to the healthcare institutions

Risk Positioning

Trend: Neutral

According to its articles of association, NWB's shares can only be held by the Dutch State and other public legal entities. The water boards own 81% of the bank, the Dutch State owns 17% and the provinces own 2%. There are no current or anticipated plans to change this ownership structure.

NWB hedges all of its currency risk as well as most of its interest rate risk. Due to the increased activity levels, the derivative exposures continue to rise. Its publicly available information is among the best for specialised lenders.

NWB is a mono-line credit provider to local government and similar entities and some significant concentration exists in its portfolio. The risk is, however, mitigated by the low risk profile of NWB's loan portfolio.

Regulatory and Operating Environments

Please refer to Moody's Banking System Outlook for the Netherlands.

Quantitative Rating Factors

Profitability

Trend: Negative

According to the preliminary result for 2008, NWB's profitability decreased in to EUR 5 million 2008 (EUR 70 million in 2006) despite slightly higher lending volume especially in the social housing and healthcare sectors. This decline was mostly driven by increased interest spreads being applied for the evaluation of the debts of central government and local authorities, decreasing the valuation of NWB's loan and securities portfolios, based on market prices. On a positive note, Moody's notes that the result excluding revaluations increased 12%.

NWB is not a profit maximising institution which is reflected in its low pre-tax profitability. NWB's high ratings reflect the bank's exceptionally strong asset quality and the fact that it has never suffered a loss on its loan portfolio.

In 2007, the bank's net interest margin declined to 0.33% from 0.38% in 2006 - margin pressure is mitigated by sound loan growth and the low risk profile of the loan portfolio.

Liquidity

Trend: Neutral

In view of NWB's reliance on market funding, it is important for it to be able to continue its business uninterrupted in the event of no access to the capital markets. NWB continues to diversify its funding by currency and type of funding. It continues to rely on issuing callable bonds and commercial paper to a greater extent than many other European specialised lenders. Recently, it has increased the size of its commercial paper programme to EUR 15 billion, partly due to the attractive rates that it can access for its own funding raising, but also in response to demand from its clients for short-term lending.

However, it should be noted that NWB's liquidity profile benefits strongly benefits from most of its portfolio of local government loans being repo-able with the central bank. Moody's understands that the administrative processes required to qualify these loans have been addressed with the central bank, and that any such transaction can be completed within 24 hours.

Capital Adequacy

Trend: Neutral

The bank's Tier 1 capital ratio has consistently been good and is among the highest for specialised lenders in Europe. However, accordingly to the preliminary result, in 2008, Tier-1 decreased to 55% from 68% in 2007 (Basel 2 definition) despite fact that lending to the Dutch public sector carries a zero risk-weighting. The bank has so far not issued hybrid capital.

Moody's considers the capital levels as ample given NWB's risk profile. Moreover, we view positively NWB's decision not to make further extraordinary payments to the shareholders from the bank's reserves in order to ensure it maintains a robust credit status after the implementation of the second pillar of Basel II, under which its interest rate and concentration risks will have a significant impact on the calculation of the adequacy of the bank's equity.

Efficiency

Trend: Neutral

Over the years, NWB has displayed one of the best levels of cost efficiencies among specialised lenders. It does not maintain a branch network on account of the specific nature of its business and operational risks. This contributes to the bank's exemplary efficiency indicators in comparison to commercial banks. In 2007, NWB's cost-to-income ratio deteriorated to 12.15% from 9.49% the previous year, driven by the decrease in income. The operating expenses were contained and stood at EUR 13 million (2006: EUR 15 million) due to a temporary reduction in staff expenses and information systems. Overall, operating expenses remained stable at 0.04% of total average assets. Both of these ratios compare favourably with those of other specialised lenders.

We expect that cost will continue to be a focus for management and also that it will remain a key profitability driver.

Asset Quality

Trend: Neutral

NWB is only able to lend to public sector entities and has never suffered a loan loss. At the end of 2007, loans to or guaranteed by public authorities in the Netherlands accounted for more than 90% of the loan portfolio, with the remainder fairly evenly split between loans guaranteed by foreign public authorities and various other loans to the Dutch public sector. At the end of 2007, 59% of the long-term loans granted by NWB were to Dutch housing associations, whose debt is guaranteed either by Stichting Waarborgfonds Sociale Woningbouw (WSW, rated Aaa) or by local governments or a combination of these. This sector, which accounted for the highest growth in the bank's loan portfolio in 2007 and 2006, has increased its borrowing over recent years, due to increased construction and regeneration of social housing, while NWB increased simultaneously its market share. Local governments (i.e. municipalities and provinces) account for 21% of the bank's long-term lending, while water boards account for 12%.

Most of NWB's lending to public entities outside the Netherlands also forms part of its investments in Medium-Term Notes for its reserves. Compared to other government-related specialised lenders, which may have substantial investments in financial companies or other highly rated private enterprises, NWB's investment criteria is relatively more strict. The bank has prudent guidelines in place for its investments. To hedge its exposure in currency and interest exposures, NWB uses derivative transactions. All counterparties are monitored and exposures must comply with internal guidelines.